



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

"YELLOW"  
NO PROTEST RECEIVED  
Release to Manager, EO Determinations - Cincinnati

DATE: [REDACTED]

SURNAME [REDACTED]

Date: JAN 18 2002

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(7). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were formed on [REDACTED], pursuant to the [REDACTED] Limited Liability Company Act. Your Articles of Organization state, in Article II, that your period of duration is thirty years or until dissolved under the terms of the Operating Agreement. Article III states that your purposes are to invest in real estate and all lawful business for which Limited Liability Companies may be organized under the above [REDACTED] statute. Article V lists your initial members, which consist of three married couples, and the [REDACTED].

Your Operating Agreement, dated [REDACTED], has been entered into by the same three married couples identified in your Articles of Organization plus [REDACTED] and [REDACTED], as Co-Trustees of the [REDACTED]. The purpose set forth in section 1.5 is the same as that stated in Article III of the Articles of Organization. Section 1.6 spells out in detail the various powers, duties, and obligations of the Limited Liability Company ("LLC" hereinafter). Most of the powers stated are of a contractual and business nature.

Section 2.1 of the Operating Agreement states that the business and affairs of the LLC shall be vested in eight (8) managers, who are the same four (4) married couples identified at the very beginning of this instrument.

Section 3.1, Paragraph (C), provides that each Member, after all capital contributions have been paid in full, shall have a share of the principal and income, and profits and losses, of the LLC as follows: each identified married couple (four altogether) has a 25% share.

Section 3.2, entitled Distributions, states in Paragraph (C) that, "Each member shall be personally responsible for any damages to the condominium unit over \$100.00 caused by his or

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[REDACTED]

her family, servants, employees, agents, visitors, guests or invitees. Each Member... shall report any damage to the condominium unit upon his or her occupancy of same."

Sec. 3.6, entitled Condominium Usage, states that,

The Members elected on behalf of the Company to maintain the accounting records shall also be elected to maintain the schedule for each Member's allocated use of the Condominium Unit, as his or her interest appears, for his or her time increment of one-week or two-week periods. ...The rotation of usage shall remain in the same order throughout the year. Members may exchange time increments, as their interests appear, by and between themselves. The process to determine usage shall require a majority vote, being seventy-five percent (75%) of the Members entitled to vote.

In response to Part II, 1 of Form 1024, exemption application, you state that the organization was formed by the Members to invest in real estate for vacation purposes only. The real estate purchased is used by the Members, or by the Members' family, friends, or business associates, for vacation purposes.

In response to Part II, 7, of Form 1024, you state, in part, that, "Membership right and shares are transferable only with the written consent of all remaining Members."

In a letter dated [REDACTED] responsive to a development from this office dated [REDACTED] you provided additional information, as follows: In #2, you confirmed that you have no other members than those already identified above. Two of the couples are related by blood — [REDACTED] and [REDACTED] are brothers. In #3, you stated that you have no plans to solicit additional members. In #4, concerning any social commingling among your Members, you responded that,

There are several times during the year where two or more of the members are utilizing the condominium at the same time. The condominium is located both at the beach and near several golf courses. The purpose of the condominium is to promote recreation among the members and guests of the members.

Section 501(c)(7) of the Internal Revenue Code provides for the exemption from federal income tax of clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, substantially all the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(a)-1(c) of the Income Tax Regulations provides that the term "private shareholders or individuals" refers to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(7)-1(a) of the regulations essentially repeats the language of Code section 501(c)(7) but also states that, in general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Rev. Rul. 58-589, 1958-2 C.B. 266, discusses the various criteria for recognition of exemption under section 501(c)(7) of the Code. In order to establish that a club is organized and operated for pleasure, recreation, and other nonproftable purposes, "there must be an established membership of individuals, personal contacts and fellowship. A commingling of the members must play a material part in the life of the organization."

Rev. Rul. 70-32, 1970-1 C.B. 132, describes a club organized to own and operate aircraft suitable for business or personal use by its members, to enable its members to improve their flying abilities, and, through the ownership and maintenance of flying equipment, to provide economic flying facilities for its members. Membership is open to all persons who are interested in flying.

Rev. Rul. 70-32 cites Code section 501(c)(7) and states that in order for a club to qualify for exemption under this section, "there must be an established membership of individuals, personal contacts, and fellowship. Furthermore, a commingling of members must play a material part in the activities of the organization." Rev. Rul. 58-589, 1958-2 C.B. 266 and Rev. Rul. 69-535, 1969-2 C.B. 126 are cited.

Held, the above-described club does not qualify for exemption under Code section 501(c)(7) because its sole activity is rendering flying services to its members and there is no significant commingling of its members.

With respect to your own application, we note that the purpose stated in your Articles of Organization - "to invest in real estate and all lawful business" - is completely outside the scope of Code section 501(c)(7). Your creating instrument makes no mention of any recreational or social purposes. Instead, a business purpose is stated. This business purpose may be inferred from your formation under the LLC statute of [REDACTED] instead of under the nonprofit statute of this State. The indication of an overriding business purpose is reinforced by the language in your Operating Agreement, which spells out at considerable length your financial and contractual powers. Further, each of your four Members has a 25% share in the principal and income, and profits and losses, of the LLC. This provision directly contravenes the requirement, under section 501(c)(7), that no part of the net earnings of a club may inure to the benefit of any private shareholder. Your four Members (married couples) are clearly "private shareholders" per the definition in section 1.501(a)-1(c) of the regulations.

Aside from the organizational defects noted above, we also conclude that you do not meet the operational test under Code section 501(c)(7) because the required commingling among your membership does not exist to any significant degree. See the holdings in Rev. Ruls. 58-589 and 70-32, discussed above. All the evidence in the administrative file points to a time-sharing arrangement for the use of a condominium apartment unit. This is reflected in the

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[REDACTED]

provisions of the Operating Agreement relating to the allocation of usage among your Members; and the information provided in Form 1024, as noted above. We take into account your statement, in Response #4 of your letter dated [REDACTED] that, "There are several times during the year where two or more members are utilizing the condominium at the same time." Nevertheless, we conclude, based on the available evidence, that, on the whole, there is very little commingling among your members in the context of the LLC operation. Basically, each of the member families uses the condominium unit as they see fit (albeit in a responsible manner) during their allotted time, and ordinarily no other members are present.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(7) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
[REDACTED] T:EO:RA:T:4  
1111 Constitution Ave., N.W.  
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Gerald V. Sack

Gerald V. Sack  
Manager, Exempt Organizations  
Technical Group 4

cc: Ohio TE/GE Customer Service Office

Code	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
	T:EO:RA:T:4	T:EO:RA:T:4				
Surname	[REDACTED]	[REDACTED]				
Date	[REDACTED]	[REDACTED]				